

Message Text

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SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE
(EDRC): REVIEW OF FINLAND

REF: (A) PARIS 35456; (B) STATE 300907;
(C) HELSINKI 2969

1. SUMMARY: EDRC REVIEW OF FINLAND PROVOKED LIVELY AND ENJOYABLE DEBATE BETWEEN SECRETARIAT AND FINNISH DELEGATION (HEADED BY LINDBLOOM OF BANK OF FINLAND, ALSO POOLMA OF BANK OF FINLAND, RELANDER OF MINISTRY OF FINANCE AND OTHERS -- DELEGATION LIST NOT CIRCULATED AT MEETING) OVER CAUSES OF 1977 FORECASTING ERROR AND PROBABLE IMPACT OF NEW 1978 POLICY PACKAGE. EDRC FELT SECRETARIAT DRAFT ON FINLAND WAS OVERLY NEGATIVE AND SUGGESTED REVISION OF TONE TO PLACE POOR FINNISH PERFORMANCE MORE CLEARLY IN CONTEXT OF WEAK DEMAND IN FINLAND'S MAJOR TRADING PARTNERS AND GIVE MORE CREDIT FOR SUCCESSFUL ASPECTS OF GOF POLICY -- PARTICULARLY ON CURRENT ACCOUNT DEFICIT. CON-
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CLUSION REACHED THAT FINLAND FACED LONG, AND POLITICALLY DIFFICULT, ADJUSTMENT WHICH WOULD BE EVEN MORE DIFFICULT UNLESS GLOBAL DEMAND ACCELERATED. COMMITTEE URGED GOF TO USE TO MAXIMUM ITS LIMITED ROOM FOR MANEUVERING BY ADOPTING RELATIVELY AMBITIOUS RATHER THAN CONSERVATIVE GROWTH TARGETS. END SUMMARY

2. REVIEW OF 1977: FINNISH DELEGATION TOOK EXCEPTION WITH SECRETARIAT'S ANALYSIS OF CAUSAL FACTORS IN VARIATION BETWEEN FORECAST AND OUTCOME FOR FINNISH ECONOMY IN 1977. WHEREAS SECRETARIAT ATTRIBUTED THREE-FOURTHS OF ERROR TO GOF UNDERESTIMATION OF LAGGED IMPACT OF 1975/76 FISCAL AND MONETARY POLICY (THUS UNEXPECTEDLY LOW LEVELS PUBLIC AND PRIVATE CONSUMPTION AND INVESTMENT), FINNISH DEL PRODUCED ALTERNATE BREAKDOWN OF DEMAND COMPONENTS WHICH ATTRIBUTES ERROR PRIMARILY TO WEAK FOREIGN DEMAND AS REFLECTED IN SLOWER THAN ANTICIPATED EXPORT GROWTH AND DRAWDOWN OF EXPORTABLES INVENTORY. FINNISH DEL ARGUED THAT WEAK EXPORT MARKETS CAUSED SUBSTANTIAL DIVERGENCE BETWEEN EXPORT DELIVERIES (A FINANCIAL VARIABLE) AND PRODUCTION (A REAL VARIABLE) NOTING FOR EXAMPLE THAT DELIVERIES OF METAL GOODS INDUSTRY INCREASED 10 PERCENT (JANUARY-SEPTEMBER, 1977) WHEREAS PRODUCTION FELL BY SAME PERCENTAGE (IN PULP/PAPER INDUSTRY, COMPARABLE FIGURES ARE PLUS FIVE AND MINUS THREE). THE LOSS OF PRODUCTION CUT INTO DISPOSABLE INCOMES AND DAMPENED INVESTMENT WHICH, WHEN ADDED TO DIRECT IMPACT OF LOWER EXPORTS AND STOCK ADJUSTMENT, MEANS THAT OVER THREE-FOURTHS OF FORECASTING ERROR CAN BE ATTRIBUTED TO EXOGENOUS FACTORS. SECRETARIAT DID NOT FULLY ACCEPT FINNISH ANALYSIS, BUT FINAL SURVEY WILL PLACE LESS EMPHASIS ON POSSIBLE POLICY ERRORS AND OTHER DOMESTIC FACTORS AND WILL HIGHLIGHT TO GREATER EXTENT LIMITED OFFICIAL USE

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ROLE OF WEAK GLOBAL DEMAND. DESPITE DISAGREEMENT ON CAUSAL FACTORS, SECRETARIAT AND FINNISH DELEGATION AGREE THAT GDP DECLINED 0.7 PERCENT IN 1977.

3. OUTLOOK FOR 1978: FINNISH DELEGATION MADE LONG PRESENTATION OF NEW POLICY PACKAGE FOR 1978 WHICH IT DESCRIBED AS BOTH A STABILIZATION AND A STIMULATION PROGRAM. WILLINGNESS OF LABOR MOVEMENT TO ACCEPT POSTPONEMENT OF SCHEDULED WAGE INCREASES WAS KEY TO PROGRAM AND DESCRIBED AS RESULT OF STRONG NEW SOCIAL CONSENSUS. BASIC AIMS OF PROGRAM ARE TO (A) RESTRAIN COSTS AND PRICES; (B) MAINTAIN CONSUMER PURCHASING POWER; (C) EXPAND EXPORTS, THUS OUTPUT IN EXPORT SECTORS; AND (D) IMPROVE THE QUALITY OF WORKING LIFE. GOF BELIEVES CPI INCREASE CAN BE KEPT TO 5 PERCENT (DECEMBER 1978 OVER DECEMBER 1977) WHILE NOMINAL HOUSEHOLD INCOME INCREASES 5 PERCENT; REAL DISPOSABLE INCOME OF THE HOUSEHOLD SECTOR THEREFORE CONSTANT. FINNISH DELEGATION WOULD NOT GIVE NEW 1978 FORECAST EXCEPT

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TO SAY THAT ZERO GROWTH OF GDP WAS MINIMUM EXPECTED,
WITH 2 PERCENT GROWTH POSSIBLE. UNEMPLOYMENT MAY RISE
SLIGHTLY, BUT FINNISH DEL ARGUED THAT PUBLICATION OF 9
PERCENT UNEMPLOYMENT FORECAST OF SECRETARIAT WOULD BE
COUNTERPRODUCTIVE IN CONTEXT OF NEW COOPERATIVE SPIRIT
FORGED BETWEEN GOVERNMENT AND LABOR MOVEMENT. ACCORD-
ING TO FINNISH DEL, FISCAL POLICY, WHEN VIEWED IN LIGHT
OF ENTIRE GOVERNMENT BUDGET (CURRENT AND FINANCIAL) WILL
BE SLIGHTLY EXPANSIONARY; MONETARY POLICY ALSO LESS RES-
TRICTIVE, ALTHOUGH NOT DISCUSSED IN DEPTH BY EDRC. SEC-
RETARIAT DUBIOUS THAT NEW PACKAGE WILL IN FACT GIVE
STIMULUS TO ECONOMY IN 1978, BUT RATHER SEES IT AS STA-
BILIZATION PROGRAM LESS AMBITIOUS THAN COULD BE TARGETED
GIVEN IMPROVEMENT IN FINNISH EXTERNAL POSITION.

4. COMPETITIVE POSITION: SECRETARIAT'S ANALYSIS AND
DESCRIPTION OF SERIOUS DETERIORATION IN FINLAND'S COMPE-
TITIVE POSITION WAS CHALLENGED BY FINNISH DELEGATION.
ATTRIBUTING CURRENT DIFFICULTIES BASICALLY TO STRUCTURAL
PROBLEMS AND WEAK DEMAND FROM TRADING PARTNERS, FINNISH
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DEL STRONGLY ARGUED THAT DEVALUATION WOULD NOT HELP BUT

RATHER WOULD CONTRIBUTE TO DOMESTIC INFLATION AND THEREFORE HARM ADJUSTMENT TO STRUCTURAL PROBLEMS. FINNISH DEL STATED ADJUSTMENT PROCESS WOULD TAKE TIME AND THAT PRECONDITION WAS REMOVAL OF COST PRESSURES WHICH HAD BUILT UP IN RECENT YEARS. SECRETARIAT'S MAJOR/MINOR CYCLES ALSO HIT ROUGH WEATHER WITH SEVERAL DELEGATIONS SUPPORTING FINNISH CONTENTION THAT 1974-77 PERIOD COULD NOT BE COMPARED TO RECESSIONS IN FIFTIES OR SIXTIES. SECRETARIAT'S ANALYSIS WILL BE RETAINED, BUT REWRITTEN TO AVOID ANY SUGGESTION THAT MAJOR DEVALUATION IS SOLUTION TO CURRENT FINNISH DILEMMA. FINNS EXPECT SUBSTANTIAL IMPROVEMENT IN COMPETITIVENESS IN 1978 BUT RECOGNIZE SLOW GROWTH BY TRADING PARTNERS WILL LIMIT POTENTIAL OF EXPORT SECTOR. INTERESTINGLY, FINNISH DEL (LINDBLOOM) SAID SLOW GROWTH IN OECD WAS NOT DUE TO LACK OF POLITICAL WILL, BUT TO STRUCTURAL NATURE OF ECONOMIC PROBLEMS WHICH WILL TAKE SOME TIME TO CORRECT -- A STATEMENT WHICH CONTRASTS SOMEWHAT WITH POOLMA INTERVENTION AT NOVEMBER EPC.

5. BALANCE OF PAYMENTS AND CAPITAL FLOWS: BANK OF FINLAND REP TOLD EDRC THAT BAG OF INSTRUMENTS NOW AVAILABLE TO GOF PERMITTED VIRTUAL TOTAL GOVERNMENT CONTROL OVER CURRENT ACCOUNT. FINNISH DEL STATED THAT GOF NOT OPPOSED TO RUNNING CURRENT ACCOUNT DEFICIT OF 2 PERCENT GDP, BUT DOES NOT AT PRESENT SEE ANY PROJECTS WHICH WOULD JUSTIFY TAKING ON THE ADDITIONAL FOREIGN DEBT. ON CAPITAL/IMPORT CONTROLS, FINNISH DEL AGAIN (SEE PARIS 36663) DEFENDED CASH PAYMENT SCHEME AS MEANS TO LENGTHEN FINLAND'S DEBT STRUCTURE AND ADDED THAT 1977 TARGET FOR LONG-TERM CAPITAL INFLOW, DESPITE CONTROLS ON LONG-TERM CAPITAL, WOULD BE MET, AFTER SHORTFALL THROUGH MOST OF YEAR HAD RAISED LIMITED OFFICIAL USE

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QUESTIONS OF AUTHORITIES ABILITY TO EXPEDITIOUSLY HANDLE THE FORMALITIES INVOLVED. ON EAST/WEST TRADE, FINNISH DEL STATED THAT BILATERAL CLEARING ARRANGEMENTS CAUSED SOMEWHAT PROCYCLICAL BEHAVIOR OF EXPORTS TO EAST, BUT ADDED THAT HEAVY PROPORTION OF CRUDE OIL IN FINNISH IMPORTS FOR USSR MEANT THAT EASTERN TRADE NOT HIGHLY SENSITIVE TO FINNISH ECONOMIC CYCLE. EASTERN TRADE HAD

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BEEN STABILIZING FOR FINLAND IN 1960'S WHEN EASTERN-
WESTERN CYCLES OUT OF PHASE, AND MORE DESTABILIZING IN
1970'S WHEN CYCLES COINCIDED. OUTLOOK FOR 1980'S POINTS
TO LARGER FINNISH EXPORTS DUE TO GROWING FINNISH IMPORT
NEEDS FOR ELECTRICITY AND RAW MATERIALS INCLUDING CRUDE.
LARGE CONSTRUCTION PROJECTS, OUTSIDE ANNUAL PROTOCOLS,
WERE ALSO CITED AS POSITIVE FACTOR IN EASTERN TRADE.

6. CONCLUSIONS: EDRC CONCLUDED THAT TONE OF SECRE-
TARIAT'S DRAFT WAS TOO NEGATIVE AND DIDN'T GIVE SUFFI-
CIENT CREDIT TO GOF FOR POLICIES WHICH HAD GONE RIGHT.
SHIFT IN EMPHASIS WAS AGREED TOWARD IMPACT OF WEAK GLO-
BAL DEMAND ON FINNISH ECONOMIC PERFORMANCE. COMMITTEE
FELT THAT NEW POLICY PACKAGE DEMONSTRATED FURTHER MOVE-
MENT IN THE RIGHT DIRECTION, BUT URGED THAT GOF NOT SET
ITS SIGHTS TOO LOW, AND AT LEAST AIM FOR GROWTH AS FAST
AS MAJOR TRADING PARTNERS (2-1/2 PERCENT GDP GROWTH AS
PROPOSED IN OCTOBER 1977 GOF FORECAST CITED AS ABOUT
RIGHT). FINNISH DEL AGREED WITH THIS APPROACH, USING
FOUR "KEY WORDS" TO DESCRIBE THE CURRENT POLICY PHILOSO-
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PHY IN FINLAND: MODERATION, COMBINATION (OF VARIOUS
POLICY MEASURES), PRAGMATISM (VS. DOGMATISM) AND PATI-
ENCE. HE SAID NO POLICY INSTRUMENT WAS BEING RULED OUT,
BUT THAT MAJOR DEVALUATION WAS NOT IN THE CARDS GIVEN
(A) THE CURRENT UNDERSTANDINGS WITH THE LABOR UNIONS;
(B) THE BASICALLY STRUCTURAL NATURE OF THE EXPORT PRCB-

LEM; AND (C) THE NEEDS OF THE SHELTERED SECTORS AS WELL
AS THE EXPORT SECTORS.
KATZ

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